

Message Text

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LAB-04 SIL-01 L-03 H-01 PA-01 PRS-01 /093 W
-----081059Z 118995 /12

R 071547Z APR 77

FM AMEMBASSY STOCKHOLM

TO SECSTATE WASHDC 0287

INFO USMISSION OECD PARIS

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E.O. 11652: N/A

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TAGS: EFIN, SW, ECON

SUBJECT: DEVALUATION OF KRONA AND GOVERNMENT ECONOMIC PACKAGE

UNLIKELY TO HAVE MUCH EFFECT IN MEETING CURRENT PROBLEMS

REF: A) STOCKHOLM 1455, B) STOCKHOLM 1456, C) STOCKHOLM A-39,

D) STOCKHOLM 1520

1. SUMMARY. ON APRIL 1 SWEDES DEVALUED OFFICIAL KRONA/DM RATE BY SIX PERCENT. ON APRIL 4 GOVERNMENT ANNOUNCED ECONOMIC MEASURES INTENDED TO LIMIT CONSUMPTION, SPUR INVESTMENT, SHIFT RESOURCES WITHIN CONSTRUCTION INDUSTRY AND REDUCE INFLATIONARY PRESSURES. THE DECISION TO ACT WAS PROPELLED BY RISING TRADE DEFICIT, INCREASING DOUBT ABOUT ABILITY OF GOVERNMENT TO COPE AND APPROACH OF DEADLINE FOR SUBMISSION OF REVISED NATIONAL BUDGET FOR FY 1977/78. DECISION WAS ALSO MADE IN MIDST OF GROWING CONCERN THAT IMPROVEMENT IN STANDARD OF LIVING MUST BE POSTPONED IN FAVOR OF SHIFT OF RESOURCES TO INVESTMENT AND IN PARTICULAR TO EXPORT INDUSTRY. SWEDES HAVE BEEN ABLE TO MAINTAIN EXTREMELY LOW UNEMPLOYMENT AND HIGH RATES OF GROWTH IN PUBLIC AND PRIVATE CONSUMPTION ONLY BY BORROWING ABROAD DURING 1975-76. SAME IS INEVITABLE FOR 1977, AND GOVERNMENT ITSELF HAS NOW HAD TO SUPPORT FOREIGN BORROWING BY ENTERING MARKET ITSELF. SITUATION CLEARLY CANNOT CONTINUE INDEFINITELY. NEVERTHELESS, GOVERNMENT PACKAGE IS UNLIKELY TO PRODUCE RESULTS ADVERTISED. DEVALUATION WILL PROVIDE ONLY A SLIGHT IMPROVEMENT IN THE CURRENT ACCOUNT BALANCE--IF ANY. INCREASED VALUE ADDED TAX WILL NOT HAVE MUCH EFFECT ON OVERALL DEMAND AND PROMISED CUTS IN PUBLIC SECTOR SPENDING ARE VAGUE. IN REAL SENSE, DEMAND MANAGEMENT IS HARDLY LIKELY TO HAVE MUCH EFFECT ON INFLATION WHICH IS CLEARLY PROPELLED BY COST PRESSURES. GOVERNMENT POLICY WILL FURTHER INCREASE EXPECTATIONS OF PRICE RISES, AND MAY ACTUALLY FORCE RATE OF INCREASE IN CPI UP TO 12 PERCENT FOR 1977. SUCCESS OF SPECIFIC LIMITED OFFICIAL USE

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MEASURES TO ACHIEVE REALLOCATION OF RESOURCES ALSO DEPENDS IN LARGE MEASURE ON WILLINGNESS OF SWEDES TO GIVE UP MANY SOCIAL BENEFITS WHICH HAVE BEEN ACHIEVED DURING POST WAR PERIOD. REPORT BELOW CITES PRESENT DANGERS WHICH DESERVE NOTE BECAUSE OF SWEDEN'S IMPORTANCE NOT ONLY IN NORDIC GROUP, BUT ALSO AS PROPONENT OF LIBERAL TRADE, PRACTITIONER OF PROGRESSIVE ECONOMIC POLICY AND EXAMPLE OF RESPONSIBLE BEHAVIOR IN WORLD OF ECONOMIC INTERDEPENDENCE. END SUMMARY.

2. SWEDISH ECONOMIC MEASURES SUMMARIZED IN REFTEL A MUST BE EVALUATED IN TERMS OF GENERAL ECONOMIC AND POLITICAL CLIMATE FACING COALITION GOVERNMENT ON FRIDAY, MARCH 25 WHEN BASIC DECISIONS WERE TAKEN BY CABINET IN SECRET SESSION. GOVERNMENT WAS FACING CUMULATIVE TRADE DEFICIT DURING DECEMBER-FEBRUARY PERIOD WHICH IF CONTINUED WOULD HAVE REACHED EIGHT BILLION KRONOR FOR 1977, IN STARK CONTRAST TO THE OFFICIAL FORECAST OF SK 3.6 BILLION. AN OVERALL CURRENT ACCOUNTS DEFICIT

OF AS MUCH AS SK 20 BILLION HAD TO BE CONSIDERED AS A
REAL POSSIBILITY. MEANWHILE DOMESTIC INFLATION JUMPED
IN JANUARY AND FEBRUARY TOGETHER BY 2.5 PERCENT.
NATIONWIDE COLLECTIVE BARGAINING NEGOTIATIONS HAD
BROKEN DOWN AND GONE INTO MEDIATION. THE OECD, IN
CONNECTION WITH ITS ANNUAL REVIEW OF SWEDISH ECONOMY,
HAD BEEN WIDELY QUOTED IN PRESS AS RECOMMENDING RE-
STRICTIVE DEMAND MANAGEMENT POLICIES, WHILE THE GOVERN-
MENT'S ATTEMPT TO PORTRAY THE OECD AS AGREEING THAT
LABOR COSTS WERE THE ROOT OF THE PROBLEM WAS APPARENTLY
INEFFECTIVE. SOME OF SOCIAL DEMOCRATIC OPPOSITION, THE
BANKING COMMUNITY, MANY BUSINESSMEN AND A WIDE CROSS
SECTION OF PRIVATE COMMENTATORS WERE CALLING FOR THE
BRAKES TO BE PUT ON PUBLIC AND PRIVATE CONSUMPTION.

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-----081059Z 119107 /12

R 071547Z APR 77
FM AMEMBASSY STOCKHOLM
TO SECSTATE WASHDC 288
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3. ECONOMIC SITUATION WAS ALSO COLORED BY FAILURE OF
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GOVERNMENT TO INSPIRE PUBLIC CONFIDENCE IN ITS ABILITY TO
MAKE HARD ECONOMIC DECISIONS. THE PRIME MINISTER HAD
SEEMED AN INDIFFERENT PROPONENT OF GOVERNMENT POLICY.
ECONOMIC MINISTER BOHMAN HAS COME ACROSS AS CONCERNED BUT UN-
CERTAIN. LABOR MINISTER AHLMARK, RESPONSIBLE FOR DIRECT EM-
PLOYMENT POLICIES, WAS BECOMING INCREASINGLY UNPOPULAR (EVEN
WITHIN THE PARTY HE HEADS, ACCORDING TO RECENT POLLS).

4. NOR DID EVIDENCE OF DISARRAY WITHIN THE COALITION
IMPROVE THE GOVERNMENT'S IMAGE. NO SOONER DID HOUSING
MINISTER OLSSON ESUGGEST A TAX ON VACATION COTTAGES TO
DAMPEN CONSUMPTION THAN BOHMAN SLAPPED HER WRIST PUBLICLY.
SVENSKA DAGBLADET (FAVORABLE TO GOVERNMENT) COMMENTED
ACIDLY ON INABILITY OF MINISTERS TO THINK BEFORE
TALKING IN AN EDITORIAL ENTITLED "HOT AIR." NOT LONG
AFTER, UNDER SECRETARY OF INDUSTRY GUNNAR SODER WAS
SUGGESTING A ONE PERCENT INCREASE IN THE VALUE ADDED
TAX (VAT) BE OFFSET BY A ONE PERCENT DECREASE IN PAY-
ROLL TAX PAID BY EMPLOYERS. ALL THREE COALITION PARTIES
IMMEDIATELY ANNOUNCED THAT STATEMENT WAS IN NO WAY A
TRIAL BALLOON. GOVERNMENT'S DECISION-MAKING PROBLEM
PROBABLY COMPLICATED BY FACT THAT MINISTER OF ECONOMY,
IN CONTRAST TO MINISTER OF FINANCE UNDER SOCIAL DEMO-
CRATS, DOES NOT HAVE CONTROL OVER BUDGET PROCESS, WHICH
IS NOW VESTED IN THE MINISTRY OF BUDGET UNDER INGEMAR
MONDEBO. SOCIAL DEMOCRATS, IGNORING THE RESPONSIBILITY
WHICH THEY SHOULD LOGICALLY SHOULDER FOR SWEDEN'S
CURRENT SITUATION, UNDER FORMER PRIME MINISTER PALME'S
BATON, EXPLOITED GOVERNMENT'S FAILINGS WITH GREAT GLEE.
(REFTEL B).

5. WITH GOVERNMENT'S PROBLEMS AND PREVIOUS PERFORMANCE
IN MIND, MOST OBSERVERS WERE SURPRISED BOTH BY EXTENT
OF MEASURES TAKEN AND SUCCESS WITH WHICH PLANS WERE
KEPT QUIET. ONLY RUMORS REGARDING SIZE OF VAT INCREASE
HAD ACTUALLY REACHED PRESS. IN FACT, INFORMATION WAS
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SO CLOSELY HELD THAT EVEN THE CENTRAL BANK'S TOP
ECONOMIC POLICY EXPERT DID NOT KNOW OF PRICE FREEZE
UNTIL PRESS RELEASE OF APRIL 4. DEVALUATION OF KRONA
WITHOUT DAMAGING SPECULATIVE CAPITAL MOVEMENTS COULD BE
SEEN BY SOME AS SUPERB HANDLING, BUT FACTS ARE THAT
POTENTIAL SPECULATORS WERE CAUGHT WITH THEIR PANTS DOWN
BELIEVING GOVERNMENT COULD NOT ACT BEFORE COLLECTIVE
BARGAINING SESSION ENDED. FINAL DECISION BECAME MORE
AND MORE UNAVOIDABLE AS DEADLINE FOR PRESENTATION OF
REVISED 1977/78 BUDGET (APRIL 30) APPROACHED.

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LAB-04 SIL-01 L-03 H-01 PA-01 PRS-01 /093 W
-----081100Z 119385 /12

R 071547Z APR 77

FM AMEMBASSY STOCKHOLM

TO SECSTATE WASHDC 0289

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6. THE GOVERNMENT HAS BEEN ON RECORD FOR SOME TIME AS
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AGREEING THAT DOMESTIC DEMAND MUST BE DAMPENED, BUT ONLY WHEN THE TIME WAS RIGHT. AS LATE AS THE MARCH 18 EDRC MEETING AT THE OECD SPOKESMAN WOHLIN WAS STILL ARGUING THAT RECOVERY OF EXPORT DEMAND WAS TOO FAR IN FUTURE TO PERMIT DOMESTIC DEFLATION WHICH WOULD ENDANGER EMPLOYMENT. HE ALSO MADE THE POINT THAT DEVALUATION, HOWEVER MUCH SOME PEOPLE THOUGHT IT MIGHT BE REQUIRED, COULD ONLY BE ATTEMPTED IF ACCOMPANIED BY STRINGENT REDUCTION IN DEMAND. THE 2.98 PERCENT INCREASE IN THE VALUE ADDED TAX WHICH PARLIAMENT MUST NOW APPROVE IS NOT LIKELY TO DAMPEN PRIVATE CONSUMPTION BY THAT AMOUNT THE GOVERNMENT HOPES. EXPERTS WE HAVE TALKED WITH, INCLUDING THE GOVERNMENT'S FORECASTING UNIT (THE KONJUNKTUR INSTITUTE--KI), THE RIKSBANK, AND SENIOR OFFICIAL IN MINISTRY OF ECONOMY, AGREE THE OVERALL EFFECT WILL BE LIMITED. DISPOSABLE INCOME WOULD GROW OVER THE YEAR AS A WHOLE BY SOME TWO PERCENTAGE POINTS LESS THAN FORECAST EARLIER--PROBABLY AROUND TEN PERCENT--IF THE INCREASE TAKES EFFECT ON JUNE 1 AS PLANNED. EARLIER INCREASES IN SPECIFIC TAXES AND FEES HAD AN EFFECT OF LESS THAN ONE PERCENTAGE POINT. HOWEVER, MARGINAL INCOME TAX RATES WERE DECREASED AS OF JANUARY 1 BY AN AMOUNT ROUGHLY EQUAL TO A 12 PERCENT INCREASE IN WAGES (4 TO 5 PERCENT INCREASE IN DISPOSABLE INCOME). GIVEN A REALISTIC PRE-TAX-CHANGE FORECAST OF MORE THAN THREE PERCENT REAL GROWTH IN PRIVATE CONSUMPTION IN 1977, THE TAX INCREASE WILL PROBABLY BRING GROWTH RATE DOWN TO ABOUT THE GOVERNMENT'S FORECAST OF 2.5 PERCENT.

7. WE HAVE NOTICED SOME UNEXPECTED WEAKNESS IN CONSUMER SPENDING--PURCHASES OF PASSENGER CARS IN THE FIRST QUARTER ARE DOWN 11 PERCENT OVER THE SAME PERIOD OF 1976--BUT WE ARE STICKING TO OUR GUESS THAT THE VAT INCREASE WILL HAVE ONLY LIMITED EFFECT. INCREASE IN CHILD BENEFIT PAYMENTS AND INDEXED INCREASES IN PENSION
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SION PAYMENTS WILL BOLSTER CONSUMPTION, AND WAGES ARE
LIKELY TO GROW BY AT LEAST FIVE PERCENT. MOST
IMPORTANT POINT OF ALL IS PROBABLY EFFECT ON CONSUMER
PRICE EXPECTATIONS. NOT ONLY MUST CONSUMERS RECKON WITH
OVERALL INCREASE IN RATE OF INFLATION, THEY KNOW
PRECISELY WHEN TAX WILL GO UP AND EXACTLY WHEN PRICE
FREEZE WILL END. WE ARE ALSO CONVINCED THAT EXPECTA-
TIONS WILL CONTRIBUTE TO DECISION TO LOWER SAVINGS
RATES TO PROTECT REAL CONSUMPTION AND THAT EFFORTS
TO PROTECT REAL SAVINGS WILL NOT BE IMPORTANT IN SWEDEN
AS IN GERMANY AND ELSEWHERE. MINISTER OF ECONOMY HAS
SAID GOVERNMENT WILL INTRODUCE MEASURES THIS FALL TO
STIMULATE SAVINGS, BUT NO CHANGE IN CREDIT POLICY IS IN
THE OFFING, AND HE HAS MADE THE SUGGESTION BEFORE WITH-
OUT ACTING ON IT.

8. NONE OF THE MEASURES ENACTED WILL REVERSE EN-
TRENCHED EXPECTATIONS OF HIGHER INFLATION RATE, YET
EVEN SWEDISH GOVERNMENT SPOKESMAN AT OECD MEETING
LABELLED THIS MOST CRUCIAL PROBLEM FACING GOVERNMENT.
HIGHER VAT WILL ADD ONE PERCENTAGE POINT TO RATE OF IN-
CREASE OF CONSUMER PRICE INDEX IN 1977. DEVALUATION
WILL ADD ANOTHER POINT. THUS, INSTEAD OF WORRYING
ABOUT PROSPECT OF ANOTHER TEN PERCENT INCREASE IN THE
CPI, THE GOVERNMENT MUST NOW FACE THE VERY REAL PROS-
PECT OF AN INCREASE OF 12 TO 13 PERCENT. FREEZING
PRICES UNTIL JUNE 1 WILL PROVIDE A SHORT BREATHING
SPELL, BUT THE MAIN EFFECT WILL BE TO MOVE FORWARD CON-
SUMPTION, AS NOTED ABOVE. IN ANY EVENT, KEY TO CON-
TROLLING INFLATION IS NOT DEMAND MANAGEMENT BUT CON-
TROL OF COSTS--BY THE GOVERNMENT'S OWN ANALYSIS.

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LAB-04 SIL-01 L-03 H-01 PA-01 PRS-01 /093 W
-----081100Z 120152 /12

R 071547Z APR 77

FM AMEMBASSY STOCKHOLM

TO SECSTATE WASHDC 0290
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9. PLANS TO RESTRICT GOVERNMENT SPENDING, WHILE NO
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DOUBT OF IMPORTANCE IN PSYCHOLOGICAL SENSE, ARE OF DE-
BATEABLE SIGNIFICANCE. NO MAGNITUDE FOR CUTS IN
NATIONAL BUDGET HAS BEEN GIVEN AND ITEMS MENTIONED SO
FAR--POSTPONEMENT OF RENOVATION OF GOVERNMENT OFFICE
BUILDINGS, FOR EXAMPLE--DO NOT PROVIDE MUCH EVIDENCE OF
SERIOUS INTENTIONS. EFFORT TO CONVINCE MUNICIPAL AND
COUNTY GOVERNMENTS TO CUT BACK ON SPENDING MIGHT GIVE
SPURIOUS INDICATION OF SUCCESS AT FIRST BECAUSE GOVERN-
MENT'S FORECAST OF SUCH SPENDING WAS PROBABLY EXAGGERATED
(REPAIR), BUT QUITE A FEW LOCAL GOVERNMENT OFFICIALS HAVE
PUBLICLY EXPRESSED RELUCTANCE TO CUT SUCH PLANNED CON-
STRUCTION AS NURSERIES AND DAY SCHOOLS. MOREOVER, SOME
80 PERCENT OF LOCAL GOVERNMENT SPENDING GOES INTO WAGES
AND SALARIES. EFFORTS TO INCREASE FEES CHARGED BY
NATIONAL GOVERNMENT TO COVER COSTS OF SERVICES RENDERED
IS ALSO LIKELY TO HAVE SMALL IMPACT ON BUDGET DEFICIT.

10. GOVERNMENT'S PLAN TO LIMIT DIVIDEND PAYMENTS IN
1977 MUST ALSO BE INTERPRETED AS PSYCHOLOGICAL MOVE
--AIMED AT MOLLIFYING LABOR. ALTHOUGH STATED INTENTION

IS TO IMPROVE LIQUIDITY POSITION OF FIRMS, INCREASE RESEARCH AND SIMULATE INVESTMENT, PROFITS ARE ACTUALLY LIKELY TO BE LOWER THAN THE ALREADY DEPRESSED LEVEL OF 1976. GOVERNMENT'S THREAT TO SKIM OFF ANY WINDFALL PROFITS OF DEVALUATION MAY PUT SOME PRESSURE ON FIRMS TO PASS ON BENEFITS OF DEVALUATION TO PURCHASERS ABROAD. WE CANNOT BELIEVE, HOWEVER, THAT DIVIDEND FREEZE WILL HAVE POSITIVE EFFECT ON INVESTMENT PLANS. SOME PRICE EFFECT FROM REDUCED DEMAND IN GOVERNMENT AND NON-PRIORITY PRIVATE CONSTRUCTION WILL HELP, BUT MOST RECENT INVESTMENT SURVEY INDICATES REAL INDUSTRIAL INVESTMENT IN 1977 WILL BE FIVE TO TEN PERCENT BELOW THE ALREADY LOW LEVEL OF 1976. KI BUSINESS CYCLE BAROMETER SURVEY COMPLETED IN MARCH CONFIRMED THAT BUSINESS PESSIMISM IS AT AN ALL-TIME HIGH. NOTE ALSO THAT DIVIDEND CEILING HAS A PERNICIOUS EFFECT AS FAR AS LIMITED OFFICIAL USE

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CONSUMPTION IS CONCERNED: GOVERNMENT EFFORTS TO DIVERT SPENDING INTO SAVINGS WILL CERTAINLY NOT BE ENCOURAGED TO GO INTO EQUITY.

11. ONE OF FEW GOVERNMENT ACTIONS WHICH BEARS PROMISE IS INTENTION TO TAX NON-PRODUCTIVE OR NON-PRIORITY INVESTMENT IN GAS STATIONS, PARKING LOTS, LARGE VACATION HOMES AND THE LIKE. FIFTEEN PERCENT TAX WILL HOPEFULLY REDUCE DEMAND ENOUGH TO RELEASE SKILLED CONSTRUCTION WORKERS. SCARCITY OF SUCH LABOR HAS CONTRIBUTED CONSIDERABLY TO WAGE DRIFT AND COST PRESSURES IN CONSTRUCTION INDUSTRY AS A WHOLE DESPITE GENERAL MALAISE AFFECTING OTHER SEGMENTS OF THAT INDUSTRY.

12. EFFECTS OF DEVALUATION HAVE BEEN LEFT FOR LAST BECAUSE OF UNCERTAINTIES INVOLVED AND DEGREE OF CONTROVERSY WHICH EXISTS AMONG ECONOMISTS REGARDING PROS AND CONS IN GENERAL. AS REGARDS SWEDEN, FIRST FACT TO KNOW IS THAT ACTUAL DEVALUATION AGAINST THE DMARK HAS BEEN ONLY 4.3 PERCENT, NOT SIX PERCENT. KRONA WAS ALMOST WEAKEST CURRENCY IN EUROPEAN SNAKE BEFORE APRIL 1. IT IS NOW ONE OF THE STRONGEST. (NEW INTERVENTION POINTS ARE DM 100 EQUAL 183.1 KRONOR, BUYING POINT; AND 191.515, SELLING POINT.) EVEN IF DEVALUATION WERE TO REACH FULL TRADE-WEIGHTED EFFECT OF 4.8 PERCENT WHICH GOVERNMENT ANNOUNCED, WE WOULD STILL HAVE GRAVE DOUBTS AS TO BENEFICIAL EFFECTS.

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13. IN THEORY, SWEDEN IS ALMOST A CLASSIC CASE FOR
WHEN NOT RPT NOT TO DEVALUE. PRICE ELASTICITY OF DE-
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MAND FOR EXPORTS IS LOW AT BEST, YET SUPPLY ELASTICITY
OF EXPORTS IS HIGH--ESPECIALLY SO WITH EXTREMELY LARGE
INVENTORIES ON HAND. DEMAND FOR IMPORTS IS ALSO IN-
ELASTIC OR BARELY GREATER THAN NONE), YET SUPPLY

ELASTICITY OF FOREIGN GOODS IS ALMOST CERTAIN TO BE HIGH AT THIS STAGE OF THE INTERNATIONAL BUSINESS CYCLE. HIGH PERCENTAGE OF IMPORT COMPONENTS IN MANY EXPORTS (AS HIGH AS 50 PERCENT IN ENGINEERING SECTOR) IS FREQUENTLY CITED AS LIMITING BENEFITS OF DEVALUATION, BUT WILL HAVE LIMITED SHORT-RUN EFFECT DUE TO LARGE INVENTORIES. IF DEMAND FOR SWEDISH EXPORTS IS ACTUALLY INELASTIC, AS MANY OBSERVERS BELIEVE, THEN DEVALUATION IN BOTH THEORY AND PRACTICE WILL HAVE PERNICIOUS EFFECT ON CURRENT ACCOUNT BALANCE. KRONA VALUE OF IMPORTS IS LIKELY TO RISE BY NEARLY THE FULL EXTENT OF DEVALUATION, WHILE KRONA VALUE OF EXPORTED GOODS AND SERVICES COULD EVEN DECLINE. FACT THAT A GOOD MANY EXPORT CONTRACTS ARE IN DOLLARS WILL FORTUNATELY PROVIDE SOME SHORT TERM OFFSET FOR LOW ELASTICITIES. ANOTHER POINT IS THAT DEVALUATION MIGHT NOT BENEFIT FROM DEMAND EFFECTS IN ANY EVENT BECAUSE OF RELUCTANCE OF EXPORTERS TO PASS ON BENEFITS. FORESTRY INDUSTRY REP HAS ALREADY BEEN QUOTED AS SAYING INDUSTRY WILL ABSORB DEVALUATION AS INCREASE IN PROFITS--WITH NO FEAR THAT PROFITS WILL BE LARGE ENOUGH TO ENCOUNTER DIVIDEND CEILING SET BY GOVERNMENT.

14. WHY THEN DID GOVERNMENT CHOOSE TO DEVALUE? ONE EXPLANATION IS HEAVY EMPHASIS PLACED ON LABOR COSTS AS DECISIVE FACTOR IN EXPORT PRICE RISES AND IN SWEDEN'S LOSS OF 17 PERCENT OF ITS OECD MARKET SHARE IN LAST TWO YEARS. WHEN CUMULATIVE TRADE DEFICIT REACHED 2.2 BILLION KRONOR IN THREE-MONTH PERIOD ENDING IN FEBRUARY, GOVERNMENT FELT IT HAD TO ACT. DECIDING FACTOR WAS PROBABLY FEAR THAT SWEDISH EXPORTS WOULD BE LEFT OUT IN THE COLD WHEN INTERNATIONAL DEMAND BEGINS TO PICK UP LIMITED OFFICIAL USE

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LATER THIS YEAR. THE GOVERNMENT ACTED ON CONVICTION THAT STEPS MUST BE TAKEN NOW IF ANY EFFECT IS TO BE FELT IN SIX MONTHS--WHEN FOREIGN UPSWING IS EXPECTED. IN MOST AVORABLE INTERPRETATION, DECISION WAS AIMED NOT A SIGNIFICANT IMPROVEMENT IN 1977, BUT AT 1978 AND BEYOND.

15. OUR BEST GUESS IS THAT TOTAL 1977 EXPORTS WILL INCREASE BY A MAXIMUM OF 2 BILLION KRONOR AS A DIRECT RESULT OF DEVALUATION. ONE BILLION IS MORE LIKELY. WITH LITTLE OR NO CHANGE IN VOLUME, SWEDISH IMPORT BILL WILL RISE BY ONE TO THREE BILLION KRONOR. PRICE INELASTICITY IN DEMAND FOR TRAVEL ABROAD AND LIKELY GOVERNMENT DECISION TO PROTECT FOREIGN EXCHANGE VALUE OF FOREIGN AID COULD ALSO LEAD TO DETERIORATION IN NON-TRADE PORTION OF CURRENT ACCOUNTS BALANCE. DECREASED DOMESTIC PURCHASING

POWER AS RESULT OF DEVALUATION AND VAT INCREASE WILL
HELP REDUCE GROWTH OF IMPORTS AND FOREIGN TRAVEL SOME-
WHAT, BUT OUR GUESS IS THAT RISING PRICE EXPECTATIONS
WILL OFFSET THIS INCOME EFFECTS.

16. END RESULT OF THESE CALCULATIONS SHOWS A CURRENT
ACCOUNT DEFICIT OF AT BEST SK 11 BILLION (ASSUMING A
TWO BILLION IMPROVEMENT OVER OUR EARLIER EXPECTATIONS OF
13 BILLION). AT WORST THE DEFICIT COULD REACH AS HIGH
AS SK 15 BILLION. IS SUCH A RESULT DISASTROUS FOR
SWEDEN? THE ANSWER IS--NOT LIKELY. SWEDEN'S ACTUAL
ECONOMIC POSITION IS FAR FROM HOPELESS. NET FOREIGN
INDEBTEDNESS WAS GENERALLY HELD TO BE ZERO AT THE END
OF 1976, AND SWEDEN'S CREDIT RATING REMAINS AT THE TOP
OF THE LIST. THUS SWEDEN IS IN
A POSITION TO CONTINUE TO BORROW TO MEET ITS SHORT RUN
DEFICITS. INCREASED DEMAND FOR SWEDISH EXPORTS, IF WE
ARE CORRECT THAT DEMAND IS MORE INCOME THAN PRICE SENSI-
TIVE, COULD THEN PROVIDE STIMULUS TO TOAL SWEDISH DE-
MAND IN 1978 AND ONWARD.
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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 SP-02 USIA-06 AID-05 EB-08
NSC-05 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PRS-01 /092 W
-----081058Z 120615 /13

R 071547Z APR 77
FM AMEMBASSY STOCKHOLM
TO SECSTATE WASHDC 0292
INFO USMISSION OECD PARIS
USMISSION EC BRUSSELS
AMEMBASSY ATHENS
AMEMBASSY ANKARA
AMEMBASSY BELGRADE
AMEMBASSY BERN

AMEMBASSY BONN
AMEMBASSY BRUSSELS UNN
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
AMEMBASSY HELSINKI
AMEMBASSY LISBON
AMEMBASSY LUXEMBOURG
AMEMBASSY OSLO
AMEMBASSY OTTAWA
AMEMBASSY PARIS UNN
AMEMBASSY REYKJAVIK
AMEMBASSY ROME
AMEMBASSY THE HAGUE
AMEMBASSY TOKYO
AMEMBASSY VIENNA

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17. IN THE LONGER RUN, HOWEVER, WHICHEVER PARTY IS IN POWER
MUST FACE THE FACT THAT GOAL OF CURRENT ACCOUNT BALANCE BY
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1980 IS NOW UNATTAINABLE. TO FIND BALANCE SWEDEN MUST NOT
ONLY COME TO GRIPS WITH EXTENSIVE STRUCTURAL PROBLEMS, NOR
SIMPLY REVERSE THE TRADE DEFICIT, IT MUST ALSO ACHIEVE
SUFFICIENT TRADE SURPLUSES TO PAY FOR AID PAYMENTS EQUAL TO ONE
PERCENT OF GDP, THE SAME FOR TOURISM, DEBT PAYMENT AND INCREASED
ENERGY COSTS.

18. IF ABOVE ANALYSIS IS CORRECT, REPRECUSIONS ON ECONOMY
WILL NOT BE SEVERE. SOME CUTBACK IN INDUSTRIAL PRODUCTION
IS INEVITABLE AND UNEMPLOYMENT RATE WILL PROBABLY DRIFT UPWARD.
WITH UNEMPLOYMENT AT AROUND 1.8 OF THE WORK FORCE IN MARCH,
A GOOD FEW LAY-OFFS CAN BE ABSORBED BEFORE RATE FOR YEAR WOULD
EXCEED 2.5 PERCENT. REAL GDP WOULD RISE BY ONLY A LITTLE MORE
THAN ONE PERCENT (THE SAME AS IN 1976.)

19. DESPITE POLITICAL RHETORIC, IT APPEARS THAT A CONSIDERABLE
DEGREE OF AGREEMENT ON BASICS IS EMERGING. "SWEDEN CANNOT
CONTINUE TO LIVE BEYOND ITS MEANS BY BORROWING ABROAD...
BUT MUST LIMIT PRIVATE CONSUMPTION, REALLOCATE RESOURCES IN THE
CONSTRUCTION SECTOR AND REDUCE (THE GROWTH OF) PUBLIC EXPEN-
DITURE." THIS QUOTE FROM PRIME MINISTER FALLDIN IS ECHOED
BY SOCIAL DEMOCRAT HEIR-APPARENT AS ECONOMICS MINISTER,
KJELL OLOF FELDT. THESE VIEWS ALSO REFLECT FOLLOWING REAL-
ITIES: DURING PAST THREE YEARS, REAL PRIVATE CONSUMPTION HAS
GROWN AT AN AVERAGE RATE OF 3.6 PERCENT, REAL PUBLIC CON-
SUMPTION BY FOUR PERCENT, BUT REAL GROSS DOMESTIC PRODUCT
BY 1.1 PERCENT.

20. AS INDICATED ABOVE, PROGRAM ANNOUNCED BY GOVERNMENT APPEARS TO HAVE LITTLE CHANCE OF ACTUALLY BEGINNING MOVEMENT TOWARD REDISTRIBUTIONS AS ADVERTISED. EXTREMELY DIFFICULT QUESTIONS ABOUT ALLOCATION OF RESOURCES AND CURTAILING OF A VARIETY OF SOCIAL BENEFITS WHICH MAY OR MAY NOT HAMPER LABOUR PRODUCTIVITY REMAIN TO BE ANSWERED. DEBATE WILL ALSO RAGE ABOUT WHO SHOULD PAY FOR NECESSARY REALLOCATION: THE SOCIAL DEMOCRATS INSIST BUSINESS SHOULD PAY BY WAY OF HIGHER PAYROLL TAXES AND ATTACK LIMITED OFFICIAL USE

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THE GOVERNMENT FOR LOWERING PROGRESSIVE DIRECT INCOME TAX RATES-- THEN RAISING REGRESSIVE INDIRECT VAT.

21. US INTEREST IN HOW SWEDES MEET THESE PROBLEMS EXCEEDS CURIOSITY REGARDING PROGRESS OF MODEL WELFARE STATE. FAILURE TO MEET PROBLEMS COULD MEAN CHANGES IN FOREIGN AID POLICY, REDUCED DEFENSE SPENDING, LESSENER COMMITMENT TO TRADE LIBERALIZATION, AND LESS SWEDISH INFLUENCE IN THIRD WORLD. SWEDES HAVE ALSO EXHIBITED CONSISTENT DEDICATION TO GOOD BEHAVIOR IN INTERNATIONALLY INTERDEPENDENT ECONOMIC WORLD. THIS IS A COMMITMENT AND AN EXAMPLE WHICH WE WOULD NOT RPT NOT LIKE TO SEE CHANGE.

22. PAST PERFORMANCE OF SWEDISH ECONOMY AND ECONOMIC DECISION-MAKERS CREATES PRESUMPTION THAT PROBLEMS WILL BE TACKLED AND SOLVED. NEVERTHELESS, IT IS BEST TO BE AWARE OF DANGERS IN STORE EVEN AT THE RISK OF UNDER-PLAYING BASIC STRENGTH OF SWEDISH ECONOMY.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: REPORTS, ECONOMIC CONDITIONS, FINANCIAL TRENDS, PROGRAMS (PROJECTS)
Control Number: n/a
Copy: SINGLE
Sent Date: 07-Apr-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977STOCKH01545
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770123-0060
Format: TEL
From: STOCKHOLM
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770476/aaaacoau.tel
Line Count: 744
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 481149a8-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 14
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 77 STOCKHOLM 1455, 77 STOCKHOLM 1456, 77 STOCKHOLM A-39
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 19-Nov-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2862405
Secure: OPEN
Status: NATIVE
Subject: DEVALUATION OF KRONA AND GOVERNMENT ECONOMIC PACKAGE UNLIKELY TO HAVE MUCH EFFECT IN MEETING CURRENT PROBLEMS
TAGS: EFIN, ECON, SW
To: STATE
Type: TE
vdkgvkey: odb://SAS/SAS.dbo.SAS_Docs/481149a8-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009